


LONDON BOROUGH OF WALTHAM FOREST

Meeting / Date	Cabinet 7 July 2022	
Report Title	Impact of Current Market Conditions on Major Capital Programmes	
Cabinet Portfolio	Councillor Ahsan Khan, Deputy Leader (Housing and Regeneration)	
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Wards affected	None	
Public Access	OPEN except Appendix 1 which is exempt under paragraph 3 of Part 1 to Schedule 12A of the Local Government Act 1972 Access to Information – being information relating to the financial or business affairs of any particular person (including the authority holding that information).	
Appendices	EXEMPT Appendix 1 – Strategic Project Updates	

1. SUMMARY

- 1.1 This report provides an overview of current market conditions – linked to rising inflation post Covid-19, the Ukraine war and Brexit – affecting the UK construction industry and recognises the potential risk these national and global factors could place on the Council's construction and home building programmes set out in its Capital Investment Strategy 2021/22 – 2026/27.
- 1.2 It also provides a cross-portfolio view of the risk of market conditions to the Council's capital investment plans and should be considered for information and good practice sharing purposes only.

2. RECOMMENDATIONS

- 2.1 Cabinet is recommended to:
 - 2.1.1 Note the current risks and issues arising from global and UK economic conditions in relation to construction cost inflation, supply chain

resilience, materials and labour availability and residential sales values, as set out in paras 3.5 to 3.8 of this report.

- 2.1.2 Note the risks associated to delivery of the Council's major capital programmes in terms of time, cost and quality, as well as the measures being taken to mitigate the impact, as detailed in paras 3.9 to 3.21.

3. BACKGROUND AND PROPOSALS

- 3.1 In February 2022 Cabinet approved a refreshed Capital Investment Strategy, which set out the Council's plans for delivering over £643 million of economic investment in the borough between 2021/22–2026/27. In 2021/22 the Council delivered over £143 million of capital expenditure – its highest annual capital spend to date – whilst successfully managing national and global issues affecting construction materials, labour and supply chains.
- 3.2 The Council recognises that the construction industry plays a key role in the national and local economy, acting as a stimulus for creating new local jobs, new homes and infrastructure. Ensuring continuity of its capital investment portfolio is a key component of the Council's priorities to make a fairer, more equal borough for all residents and its economic and high street recovery plans for the borough.
- 3.3 The £643 million of planned investment will deliver substantial benefits to our local communities and businesses, including c.4,000 new homes (of which c.2,000 will be affordable), over 1,000 local construction and supply chain jobs, 300 apprenticeships and 450 work placements for local people, c.680 long-term jobs, c.29,000 sqm of cultural, community and commercial floorspace, and over 1,000 new trees planted.
- 3.4 2022/23 is a significant year for the Council's capital investment plans, with a number of strategically important projects hitting critical milestones during the year. This includes the planned completion of the Soho Theatre Walthamstow and Juniper House on Hoe Street, and the start of the second phase of regeneration at Fellowship Square, delivering 433 new homes, a new civic building and commercial units. Additionally, the Council's housing company, Sixty Bricks, is due to complete the delivery of all phase 1 developments, which will deliver 480 (50% affordable) new homes across the borough.

Impact of market conditions on the Construction Industry

- 3.5 The UK construction industry is under continued pressure from global factors including the conflict in Ukraine and further coronavirus lockdowns in China, which are leading to difficulties in predicting costs, materials shortages and cost increases, and supply chain disruptions. These pressures have been exacerbated by rising energy costs affecting the manufacturing supply of energy intensive materials key to the construction industry, such as cement, steel and bricks.

- 3.6 The material price index for 'All Work' increased by 24.5% in March 2022 compared to the same month the previous year (Source: [Monthly Statistics of Building Materials and Components](#)) and housing construction cost inflation during the year to March 2022 was 10.9% (Source: [ONS Construction Output Price Indices](#)). Tender prices rose by 6.5% throughout 2021 and it is predicted that tender increases will continue over the first three quarters of 2022 in the order of 5% to 7% per annum (Source: *Building Cost Information Service*).
- 3.7 House price growth and buyer demand in London has increased in recent months, with a continued lack of supply of properties and increasing buyer enquiries putting upward pressure on prices. However, there is uncertainty around the extent to which house prices at lower price bands will continue to grow in the medium to longer term, due to the increasing cost of living. (Source: [GLA Housing Market Report April 2022](#)).
- 3.8 Although house price inflation has been strong for new build property in the year to February 2022 at 19.9% (Source: [ONS UK House Price Index March 2022](#)), [Knight Frank research](#) indicates that as interest rates rise to combat high inflation, we may see a slowdown in residential sales and house price growth. This, together with increased supply locally and the end of the Help-to-Buy equity loan scheme – which is currently due to end in March 2023 – means that residential sales values on the Council's new build properties may decrease, thereby affecting expected income to the Council and overall scheme viability.

Impact on the Council's construction and house building programmes

- 3.9 As noted above, the Council's capital investment portfolio comprises a number of significant residential-led and mixed-use regeneration projects, which are currently at a critical stage in delivery during their construction phase, and are therefore more susceptible to market volatility and supply chain disruption, including labour and materials availability.
- 3.10 Council officers have embedded a robust cross-portfolio and project-level risk management process, which has thus far mitigated risks and issues arising from market conditions, ensuring delivery continuity during and post pandemic. However, the additional impact of recent materials cost inflation, further labour and materials shortages, energy cost increases and global supply chain disruption means that the Council's delivery partners are under significant pressure, which the industry expects to continue throughout this financial year.
- 3.11 To date, Council officers' enhanced risk management practices across the capital portfolio have noted the following interdependent issues, which are beginning to affect delivery of schemes currently on site:
- 3.11.1 **Programme delays:** there is a consistent trend of delays being reported by contractors across schemes currently on site, due to:
- Supply chain resilience i.e., suppliers/subcontractors defaulting or going into administration.

- Labour shortages.
- Materials availability and longer lead-in times (where pre-ordering and stockpiling has not been possible).

3.11.2 **Cost pressures:** contractors are making losses on fixed price contracts due to inflation far exceeding allowances included at tender stage. While the Council remains in a strong position contractually, this has led to an increase in contractor claims, as they seek to recoup their losses. Genuine Extension of Time (EoT) claims will result in prolongation of the delivery programme and therefore additional costs to the Council.

3.11.3 **Contractual relationships:** As noted above, contractors are adopting an increasingly commercial position as a result of market conditions. This has led to increased contractor claims, difficulties agreeing valuations and final accounts.

Mitigation strategy

- 3.12 It should be noted that all capital project and programme budgets contain a risk allowance for construction cost inflation based on industry forecasts, as well as further project contingencies. Budgets are closely managed at a project and programme level and cost plans updated regularly to ensure any cost increases can be accommodated within existing budgets, risk allowances and contingencies. Project, programme and portfolio level monitoring provides additional assurance around risk of delays and/or cost increases for priority and high value schemes.
- 3.13 For its largest capital schemes (i.e., new build residential or mixed use), which have long delivery programmes and therefore most exposure to cost uncertainties, the Council has entered into fixed-price Design & Build contracts or taken a developer-led approach. This reduces risk to the Council by transferring construction cost inflation risk to the contractor/developer. Although it should be noted that the Council remains liable for the additional cost and/or delays associated with any late client changes to the specification (design, materials etc.). As such design freeze at close of procurement is increasing in practice.
- 3.14 Potential delays related to current market conditions are generally being managed through re-programming of works. Any EoT claims submitted by contractors under fixed-price contracts are carefully assessed to minimise delays and costs to the Council. Risks around supply of materials and labour continue to be monitored regularly by all parties with schemes enhancing Employer's Agent functions to provide further assurance to project level budgets and delivery plans.
- 3.15 Design and Build contracts also include provision for the Council as client to apply Liquidated and Ascertained Damages (LADs) where additional costs have been incurred as a result of contractor delays, therefore offsetting these costs.
- 3.16 For developer-led schemes, rigorous procurement processes ensure that the developer's modelling factors in appropriate risks, and confirms they have a robust financial model, financial stability and funding in place

to maintain delivery. Where Development Agreements have already been entered into, risks related to materials/labour supply and cost increases have been transferred to the developer through the contractual structure.

- 3.17 However, there is a risk that any significant delays in delivery could lead to additional project level costs, which the Council may need to fund from borrowing. This would in turn lead to increased interest and debt repayment costs. Enhanced cost consultancy services have been put in place to closely monitor this risk.
- 3.18 The Council delivers its capital investment portfolio by using a mix of delivery models and through a broad range of providers. This spreads exposure to market conditions and other risks which may impact a single supplier.
- 3.19 Project Managers and SROs continuously work with development partners to proactively manage risk, minimise delays and monitor overall viability of developments as they progress. Robust governance also ensures gateway reviews are standard practice, ensuring schemes must deliver within time and cost tolerances before being approved to progress.
- 3.20 At a portfolio level, the Council refreshes its Capital Investment Strategy on an annual basis. The refresh of the capital strategy reviews multi-year budgets to ensure that its overall programme is affordable and forms a key component of its Medium Term Financial Strategy (MTFS) and longer-term budget strategy. Furthermore, strict financial monitoring of the inflationary impact takes place and action is taken to mitigate the impact on the General Fund and Housing Revenue Account.
- 3.21 As previously noted, capital projects include risk allowances for construction cost inflation, contingencies, and have other mitigation measures in place as set out above. However, should further claims be received above existing contingency allowances, it will be necessary to revert to Cabinet (or the relevant decision maker) to seek approval of additional funding for each project/programme.
- 3.22 Appendix 1 provides delivery updates for projects of strategic importance to the Council - Fellowship Square Phase 2 and Soho Theatre Walthamstow - including project specific risks aligned to current market conditions. The information in appendix 1 is exempt from public and press under paragraph 3 of Part 1 to Schedule 12A of the Local Government Act 1972 (Information relating to the financial or business affairs of any particular person including the authority holding that information).

4. OPTIONS & ALTERNATIVES CONSIDERED

- 4.1 There are no options or alternatives to set out in this report, which assesses potential risks to Council delivery plans caused by external factors.

5. SUSTAINABLE COMMUNITY STRATEGY PRIORITIES (AND OTHER NATIONAL OR LOCAL POLICIES OR STRATEGIES)

- 5.1 The Council's construction and house building programmes are strategically planned and aligned to support the delivery of its corporate priorities including delivery of a fairer, more equal borough in response to the cost-of-living crisis, reducing the inequality gap and responding to the housing crisis through investment in the delivery of new and affordable homes (including social rented) and local jobs.

6. CONSULTATION

- 6.1 The issues set out in this report have been the subject of formal consultation with senior officers and members, including via the Council's Capital Strategy and Asset Management Group (CSAMG) and Management Board.

7. IMPLICATIONS

7.1 Finance, Value for Money and Risk

- 7.1.1 Before individual capital schemes can commence, they are subject to a gateway process to ensure deliverability and viability. Decisions will need to be made about the scale and affordability of any new capital projects, building in inflationary risk. Section 3 of this report sets out the robust financial and value-for-money strategy adopted by the Council to manage risks at a project, programme and portfolio level.
- 7.1.2 The risks raised in this report need to be initially addressed by individual project teams to reduce / mitigate as much of the financial impact as possible. Only then will the projects be allowed to request funding from the portfolio level contingency of £14m, which was agreed in the Capital Strategy agreed as part of the Budget in February Council.
- 7.1.3 Any capital spend on existing projects, which is outside the £14m contingency (and cannot be contained through additional grant, capital receipts or other income) will have a detrimental effect on the General Fund through additional borrowing requirements and therefore the associated Minimum Revenue Provision (MRP) and interest costs the Council will incur and will be subject to a return on investment review of the scheme to ensure continuing value for money.

7.2 Legal

- 7.2.1 There are no legal implications arising from this report which assesses potential risks to Council delivery plans caused by external factors.

7.3 Equalities and Diversity

- 7.3.1 There are no equality and diversity implications arising from this report.

7.4 Sustainability (including climate change, health, crime and disorder)

- 7.4.1 There are no sustainability implications arising from this report.

7.5 Council Infrastructure

7.5.1 There are no infrastructure or ICT requirements arising from this report.

BACKGROUND INFORMATION (as defined by Local Government (Access to Information) Act 1985)

None